US Bancorp Center
800 Nicollet Mall
Minneapolis, MN 55402

July 6,2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Docket No. R-1193

Dear Ms. Johnson:

U.S. Bancorp welcomes the opportunity to respond to the Board of Governors of the Federal Reserve System ("the Board") regarding the Notice of Proposed Rulemaking on Trust Preferred Securities and the Definition of Capital.

The rule proposes a number changes that U.S. Bancorp believes are needed. There are several provisions of the proposed rule that we believe need further analysis and we believe that changing the composition of tier 1 capital warrants a further review of tier 1 capital.

We urge the Board modify the definition of internationally active banking organizations to be consistent with the proposed New Basel Capital Accord ("Accord"). The proposed rule defines an internationally active banking organization as an organization that has significant activity in non-U.S. markets or is considered a candidate for the Advanced Internal Ratings Based Approach ("AIRB") under the Accord. We urge the Board to adopt the same definition listed in the Advance Notice of Proposed Rulemaking for the New Basel Capital Accord. In the Accord, the scope of application is defined as banking organizations with assets in excess of $250 billion or foreign assets of $10 billion.

We encourage the Board to maintain a consistent definition of internationally active banking organizations. The use of a standard that applies to any bank following the AIRB approach will limit the number of banks subject to the AIRB. Currently there are banks that are not internationally active that are considering voluntarily adopting the AIRB. If adopting the AIRB limits a bank's ability to compete with other domestic banks due to a limitation on their capital structure, there will be fewer banks that will adopt the Accord.

Domestically banks compete vigorously. A difference of 10% in the allowance of innovative instruments results in a material difference in the cost of capital. Ranks using the 15% limit will be forced to issue higher cost capital to maintain the same overall level of tier I capital that they hold today.

The U.S. banks have to meet additional capital requirements that foreign banks are not required to meet. These include tier 1 leverage ratios and prompt corrective action (PCA) requirements. These regulatory and statutory requirements increase the level of capital held by U.S. banks. The FDIC conducted a study in late 2003 of the capital ratios of the world's 100 largest banks. The study showed that U.S. banks held substantially more capital than banks around the world. We believe that the leverage ratio and PCA are significant contributory factors for the higher capital ratios. The reduction of trust preferred securities to 15% of tier 1 capital will significantly increase the capital costs for domestic banks that foreign banks will not be required to meet due to the differences in the regulatory capital requirements.

The Board cites an agreement in 1998 among the G-10 banking supervisors limiting the use of innovative capital instruments to 15% of tier 1 capital. We believe that the spirit of the agreement was to present a level playing field among internationally active banks. Given that U.S. banks in general have substantially higher capitalization ratios than foreign banks, we submit that having a limitation of 25% on innovative capital instruments is consistent with the spirit of the international agreement. There is a strong public policy benefit for U.S. banks to maintain strong capital ratios. Limiting the use of innovative capital instruments will surely lead to overall lower tier 1 capital ratios at large banks in the U.S. We believe that allowing all U.S. institutions to use innovative capital instruments up to 25% of tier 1 serves both the public policy purpose and the spirit of the G-10 agreement.

The U.S. regulators should be able demonstrate to the G-10 supervisors that U S . banking institutions have substantially the same or higher tier 1 capital ratios than large banking institutions at G-10 countries using the same limitation of 15% on innovative instruments. The circumstance that U.S. banking organizations choose to issue more than 15% of trust preferred securities to achieve a higher tier 1 capital ratio than banks in other G-10 countries provides a public policy benefit to U.S. taxpayers and the FDIC.

Given that the Board is proposing a change in the composition of tier 1 capital. We urge the Board to consider other changes to tier 1 capital to maintain a consistent definition of capital. We believe that the current treatment of merchant processing assets is out-of-date with current market expectations. The market has clearly recognized the value of merchant processing assets for banking firms. The market perceives value to these assets and a risk level that is much lower than the current capital requirements. We believe that the definition of tier 1 capital should be revised to include these market expectations and the actual value of these assets.

The merchant processing assets are liquid and as observable as other servicing assets such as mortgage servicing and credit card servicing, There have been substantial developments in the liquidity of merchant processing assets. They are as liquid as these other servicing assets.

Wc **would be pleased** to **provide** more information about **the** market pricing **and** value of merchant **processing** assets. We also urge the Board to retain **the** 25% limit for trust preferred securities **and** to **use** the **New** Basel Accord definition of internationally active **banks.**

Sincerely,

Daryl N. Bible
Executive Vice President & Treasurer
U S . Bancorp